Supreme Court, U.S.
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No. 01-409

IN THE

Supreme Court of the United States

DOMINIC F. GANGALE,
DALE M. GANGALE,

Petitioners,

v.

PENSON FINANCIAL SERVICES, INC.,

Respondent.

On Petition For Writ Of Certiorari
To The United States Court of Appeals
For The Eleventh Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

Petitioners present six questions, none of which are appropriate for consideration, as they do not satisfy the standards for Supreme Court review.

The Eleventh Circuit's decision is subject to factual review only if "clear error" is evident, yet Petitioners allege no such factual error. Although the Eleventh Circuit's decision is subject to review on a *de novo* basis concerning the proper legal standards of the Federal Arbitration Act, Petitioners do not point to any errors of law, except to the extent they boldly assert that the Eleventh Circuit's decision is "in direct conflict with the . . . cornerstone decision of Gallagher v. Jones . . . (sic)" However, there is no discussion of this alleged conflict because it is non-existent.

The Eleventh Circuit clearly addressed the proper legal question: did Petitioners prove a "manifest disregard for the law" by the arbitration panel when it applied the measure of damages adopted by the Supreme Court in *Galigher v. Jones*, 129 U.S. 193 (1889) and by the courts of Texas in directly comparable circumstances? Petitioners did not and can not prove such a "manifest disregard."

The only possible question properly reviewable now is "Did the Eleventh Circuit correctly apply the appropriate standard of review pursuant to the Federal Arbitration Act?" Any other factual or legal analysis in the Petition is extraneous and insignificant to this appeal.

DISCLOSURE STATEMENT PURSUANT TO RULE 29.6

Respondent Penson Financial Services, Inc. ("Penson") was, at the time of the Arbitration Award, a division of Service Asset Management Company, Inc., but is now a subsidiary of Penson Worldwide, Inc. There is no publicly held company that owns ten percent (10%) or more of Penson's stock.

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STATEMENT OF THE CASE

Petitioners Dominic F. and Dale M. Gangale ("Petitioners" or "the Gangales") continue their appeal of a unanimous arbitration award in their favor ordering Respondent Penson Financial Services, Inc. ("Penson") to pay the Gangales $26,924.88 (the "Award"). The Award was made by a duly appointed panel of three arbitrators from the Office of Dispute Resolution of NASD Regulation, Inc. in Case No. 98-0133 after six days of hearings. Penson tendered full payment of the Award within the time prescribed by applicable NASD rules.[1] The Gangales challenged the Award in the United States District Court for the Middle District of Florida. Judge James S. Moody confirmed the Award, expressly refusing to modify or vacate it. The Gangales appealed that decision to the United States Court of Appeals for the Eleventh Circuit, which found no reversible error and affirmed the District Court decision. In their Petition for Writ of Certiorari, the Gangales assert for the first time ever that this case involves Rule 405 of the New York Stock Exchange, Rule 2110 of the NASD Manual (sic: NASD Conduct Rule 2110), Rule 240.10b-5 of the Securities & Exchange

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[1] During the pendency of their appeal to the Eleventh Circuit, the Gangales negotiated the check they received from Penson in payment of the full amount of the Arbitration Award. Thus, their appeal is mooted by the "acceptance of benefits" doctrine. See *Fidelcor Mortgage v. Insurance Co. of North America*, 820 F.2d 367 (11th Cir. 1987). Although Penson filed a Motion to Dismiss in the Eleventh Circuit on this point, the motion was denied as moot in light of the court's affirmance of the district court decision.

Commission, the Securities & Exchange Act of 1934 [15 U.S.C. §20(a)] and Rule 2310-2 of the NASD Manual (sic: NASD Conduct Rule 2310-2). None of these statutes or rules have been brought to the attention of, nor were they expressly considered by, the arbitration panel or the courts below.

The facts before the arbitration panel were relatively straightforward. In 1996, the Gangales opened a securities brokerage account with Penson, as clearing broker, through Empire Financial Group, Inc. ("Empire"), their introducing broker.[2] Mr. Gangale proceeded to engage in highly speculative and extremely risky trading in options on margin in that account and the account value fluctuated significantly from month to month. At the end of December, 1997, when the account had a negative value of almost $400,000, Empire notified Mr. Gangale of significant margin calls for the account and the necessity for liquidating the positions in the account unless additional collateral was placed in the account. After some negotiation, Mr. Gangale and Penson entered into a Memorandum of Agreement pursuant to which Mr. Gangale made a collateral assignment of two notes with a face value totaling $1,000,000 (the "Collateral Notes")[3] and Penson agreed that

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[2] The Gangales chose not to name Empire as a party to the arbitration.

[3] The actual value of the Collateral Notes has never been determined, as Penson was unable to obtain any financial data concerning the maker.

> Providing the absence of further account deterioration as it relates to account balances as of December 29, 1997, Penson will allow Gangale to "roll forward" any option position and generally allow Gangale to trade on the account, with the intent to betterment the capitalization of said account, providing no additional risk is created.

In February, 1998, Empire (which did not sign the Memorandum of Agreement) requested that Petitioners provide additional margin to support the continuation of their highly speculative trading. When Petitioners failed to meet that margin call, Empire ordered the liquidation of the positions in the Gangales' account.[4] After liquidation, there was a negative net balance of over $13,000 in Petitioners' account (not counting the Collateral Notes, which Penson held until the negative balance was retired through collections from the maker of the Collateral Notes).

In April, 1998, the Gangales filed a Statement of Claim with the Arbitration Department of the National Association of Securities Dealers, alleging that they had suffered significant losses because Penson had liquidated their account

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[4] Empire was liable to Penson for all losses in every customer account, including the Gangales' account, and was, accordingly, also "at risk." Empire also had a contractual right under the Gangales' account agreement to terminate the account.

(rather than Empire)[5], even though, they claimed, the account had not deteriorated. Arbitrators were appointed through applicable NASD procedures.

At the arbitration, the Gangales submitted an expert's report calculating damages according to *Mercantile Holdings, Inc. v. Keeshin*, 633 N.E.2d 805 (Ill. 1st Dist. 1993), showing that, had the account not been liquidated and Mr. Gangale's trading strategy been followed, the Gangales' account could have increased in value by $1,232,437. On cross-examination of the Gangales' expert, he admitted to several errors and shortcomings in his calculations.

Penson contested liability, but also submitted expert testimony on the issue of damages, calculating damages according to *Galigher v. Jones*, 129 U.S. at 202. In a written report, Penson's expert showed that, if Penson were liable to the Gangales at all, the damage they suffered was only $26,924.88, the net difference between liquidation prices obtained on the sale of the Gangales' positions and the highest prices obtainable for those positions over the following five days. Although the arbitrators did not state the method they used for calculating damages, they awarded the Gangales $26,924.88, the exact amount of damages using the *Galigher* damage model.

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[5] Until the actual arbitration hearing, the Gangales erroneously believed that Penson, not Empire, had initiated the liquidation of this account.

REASONS FOR DENYING THE PETITION

There is simply no valid reason - - and certainly not any compelling reason, required by Rule 10 - - for the Court to exercise its discretionary authority to review the Eleventh Circuit decision.

In affirming the District Court's decision, the Eleventh Circuit correctly applied the applicable standard from 9 U.S.C. §10, as re-articulated in *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456 (11th Cir. 1997). Specifically, Petitioners failed below, and have failed again here, to show that the Award should be vacated due to a manifest disregard of applicable law by the arbitration panel. The Circuit Court properly found "no merit" to Petitioners' claim that the calculation of damages represented a manifest disregard of applicable law.

Similarly, the Circuit Court properly found "no merit" to Petitioners' claim of "evident partiality" by the arbitration panel, correctly finding that Petitioners failed to establish a "reasonable impression of partiality" which is "direct, definite, and capable of demonstration rather than remote, uncertain and speculative...." *Lifecare Int'l, Inc. v. CD Medical, Inc.*, 68 F.3d 429, 433 (11th Cir. 1995).

I.

PETITIONERS ERRONEOUSLY ATTEMPT TO DISTINGUISH WRONGFUL LIQUIDATION DAMAGES FROM BREACH OF CONTRACT DAMAGES AND ERRONEOUSLY CONTEND THAT THE ARBITRATORS' REFUSAL TO ACCEPT PETITIONERS' ALLEGED DISTINCTION AMOUNTS TO "MANIFEST DISREGARD OF APPLICABLE - LAW" AND "INTENTIONAL MISCONDUCT."

Petitioners mistakenly contend that this is not a wrongful liquidation case. The Memorandum of Agreement upon which Petitioners filed their arbitration action can only be described as a contract by which the Petitioners agreed to provide additional collateral to maintain their option positions in exchange for an agreement by Penson not to liquidate the account "providing the absence of further account deterioration" and "providing no additional risk is created." Petitioners contend Penson breached this contract when Empire (not Penson) liquidated Petitioners' account upon their failure to provide additional equity for the margin account. Since Petitioners' account was liquidated despite an agreement limiting Penson's liquidation rights, the only issue presented is whether that liquidation by Empire was a wrongful act of liquidation by Penson.

The method for calculating damages resulting from a wrongful liquidation is plainly stated by the Court in *Galigher*

v. Jones, and that method has been adopted and applied in similar cases by the courts of Texas (whose law governs the Petitioners' account). See *Reed v. White, Weld & Co., Inc.*, 571 S.W. 2d 395, 397 (Tex. Civ. App.-Texarkana 1978, no writ).[6] The Eleventh Circuit correctly noted that Petitioners "offer no reason to believe the arbitration panel's decision to apply the measure of damages adopted by the Supreme Court and the courts of Texas for cases where a broker violates a contract by liquidating securities positions was anything more than a misinterpretation or misapplication of the law (if it was even that). Accordingly, they have not shown a 'manifest disregard for the law' by the arbitration panel." Citation to *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456, 1462 (11th Cir. 1997).

Moreover, Petitioners are asking this Court to apply a measure of damages that is highly speculative and fraught with opportunities for flawed results. Rather than the simplicity used by the Texas court in *Reed v. White* ("the true

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[6] Petitioners claim *Galigher* is not appropriate precedent because it is "a wrongful liquidation case, not a Contract case." [Petition at p. 12] Petitioners mistakenly quote from a lower court opinion reviewed in *Galigher*, which read "I do not...find any contract or understanding...." However, Petitioners fail to recognize that the Supreme Court disagreed and found: "In this we think the court was in error." *Galigher* at 198. *Galigher* addresses "the measure of damages in stock transactions of this kind...." *Galigher* at 200. The stock transactions under review in *Galigher* involved a broker's assumption of control over his principal's stock and the sale of that stock at an unfavorable time for an unfavorable price. Because stocks fluctuate in price, the Court found need for a specific rule for the calculation of damages in such circumstances and clearly provided one. *Galigher* at 202.

and just measure of damages is the highest intermediate value of the stock between the time of its conversion and a reasonable time after the owner has received notice of the conversion to enable him to replace the stock." Id.) Petitioners' damage model was based on rank speculation, specifically reciting that the calculations included "a security-by-security position analysis employing trading strategies consistent with Mr. Gangale's past trading history and his trading instructions."[7] This kind of retrospective analysis with the benefit of hindsight was rejected in *Reed*. That approach was also rejected in *Lichter v. Paine Webber, Jackson, Curtis, Inc.*, 573 F. Supp. 533 (N.D. Illinois, 1983), where a customer challenged Paine Webber's liquidation of bonds. The court wrote:

> "Thus Lichter's only demonstrable harm lay in the fact of liquidation of the IH bonds by Paine Webber. The event triggered his damages, if any, and that event defines when any damages were sustained. Because full market price was realized for the bonds, Lichter must look elsewhere for any damages. And on that 'elsewhere' score, it is not as though Paine Webber had converted an irreplaceable Van Gogh. Replacement IH bonds were readily available on the market if Lichter wanted them and had the price. If he did not have the price

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[7] Rather than determine a specific date as a "reasonable period" for the determination of damages, Petitioners' expert selected hypothetical and varied trade dates, months after the liquidation, to maximize Petitioners' claim for damages.

> he cannot complain, for by definition he would have been unable to meet his cash margin obligation and could have been sold out by Paine Webber as a matter of right."

Id. at 536. Here, Petitioners wildly contend that their contract with Penson contained "concessions [presumably by Penson] that would otherwise not be granted to anyone." Petitioners then stretch their argument to an untenable conclusion: "Thus, the Gangale contract took the form of a Van Gogh that could not be duplicated anywhere." [Petition at p. 13, footnote 4] This convoluted analysis ignores the absolute and unquestionable reality that the liquidated securities could have been replaced within two minutes, but Petitioners either were not able to do so or elected not to do so. Whatever their reason for not re-entering the market, Petitioners have no proper complaint against Penson.

Following century-old Supreme Court precedent is not a "manifest disregard for the law."

II.

PETITIONERS FAILED TO SATISFY THEIR BURDEN UNDER THE FEDERAL ARBITRATION ACT

When, as here, a district court has confirmed an arbitration award, the Eleventh Circuit could only review the district court's findings for "clear error", and its holdings of law on a "de novo" basis. *First Options of Chicago v. Kaplan*, 514 U.S. 938, 947 (1995); *Gianelli Money Purchase Plan and Trust v. ADM Investor Services, Inc.*, 146 F.3d 1309, 1310 (11th Cir., 1998). Based on these unmistakable precedents, the Eleventh Circuit had to be mindful that arbitrators must be given considerable leeway in their decision-making and that vacation of an arbitration award is to be permitted only in extremely limited circumstances. Indeed, the standard is of particular significance in this case, since Petitioners seek to overturn or modify an Award in an arbitration in which they sought - - and obtained - - damages.

The applicable legal standard for modifying an arbitration award is found at Section 11 of the Federal Arbitration Act:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon application of any party to the arbitration –

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award. ...
>
> 9 U.S.C. § 11

Similarly, the applicable legal standard for vacating an arbitration award is found at Section 10 of the Federal Arbitration Act:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration –
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> * * *
>
> (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
>
> (c) Where the arbitrators were guilty of misconduct . . . in refusing to hear evidence pertinent and material to the controversy; or of any other

> misbehavior by which the rights of any party have been prejudiced....
>
> 9 U.S.C. §10

Petitioners have wholly failed to satisfy either standard.

Petitioners' only argument which even comes close is a feeble claim of partiality, but it falls well short of the requirements of *Lifecare Int'l, Inc. v. CD Medical, Inc.*, 68 F.3d 429, 433 (11th Cir. 1995)

Rather than show how these statutory requirements are met, Petitioners unnecessarily burden the record with misstatements, inappropriate references and claims for which there was no support before the arbitration panel. References to tape recordings that Petitioners claim would be damaging to Penson are based on nothing more than conjecture.[8] Moreover, references to arbitration decisions concerning collective bargaining agreements are irrelevant to this dispute. References to "control person" tests under the securities laws similarly have no application to this case.

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[8] For example, the bold assertion that a Penson employee stated "if you want the note back, I [sic: you] can have the note back" is plainly wrong and is quoted out of context. [Petition at p. 7] The taped conversation between Empire's principal and Mr. Gangale occurred before the final liquidation of Petitioners' account for failure to satisfy a maintenance call, and not after, as Petitioners appear to suggest.

Before an arbitration award will be vacated, the party challenging the award must establish a "reasonable impression of partiality" which is "direct, definite and capable of demonstration rather than remote, uncertain and speculative[;]...the mere appearance of bias or partiality is not enough to set aside an arbitration award." Id.

Petitioners also complain that they made an involuntary withdrawal of a "memorandum of law" which Mr. Gangale had written, and which, they contend, had been accepted for consideration by the panel. While the parties worked on a schedule for Penson to respond to this "memorandum of law," the panel chair commented that he had never seen a "memorandum of law" submitted by a client. He added: "Having said this and I have said it before, I wanted you to know what I consider an unusual procedure will not influence me one way, in any way in rendering a decision." He then asked Petitioners' counsel "Do you feel the same way?" And the lawyer answered, "Yes" and asked for two minutes to confer with his client. Immediately following that conference, the memorandum was withdrawn, thereby obviating the need for a responsive memorandum from Penson.

Petitioners' counsel, knowing that the "memorandum of law" had been withdrawn, told the panel: "On behalf of the Claimants, we have had a full and fair opportunity to be heard." Penson's counsel agreed. Thereafter, Penson's counsel handed the chairman of the arbitration panel a copy of the Texas case adopting the *Galigher* standard, having previously argued in his closing that failure to follow the

Galigher precedent would be a manifest disregard of the applicable law.

This Court must simply disregard Petitioners' argument for what it plainly is: a futile attempt to claim partiality by the arbitration panel because the arbitrators chose to follow the applicable law. It can not serve as a basis for vacating an arbitration award.

CONCLUSION

For the foregoing reasons, Penson respectfully requests that this Court deny the Petition of Writ of Certiorari. The Eleventh Circuit's decision is a proper application of a longstanding principle of law, and this case raises no significant legal issues that warrant review.

Respectfully submitted, this 5th day of October, 2001.

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